AUSTIN ENERGY'S TARIFF PACKAGE: 2015 COST OF SERVICE STUDY AND PROPOSAL TO CHANGE BASE ELECTRIC RATES	**§ § § §**	**BEFORE THE CITY OF AUSTIN IMPARTIAL HEARING EXAMINER**

AUSTIN ENERGY'S REPLIES TO EXCEPTIONS TO IMPARTIAL HEARING EXAMINER'S REPORT

AUGUST 1, 2016

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TO THE HONORABLE IMPARTIAL HEARING EXAMINER:

COMES NOW, Austin Energy ("AE") and files these Replies to Exceptions to the Impartial Hearing Examiner's Report ("Report") issued July 15, 2016 in the above referenced proceeding.

I. INTRODUCTION

Four intervenors filed Exceptions to the Report. Those four parties, Austin Energy Low Income Consumers' ("AELIC"), NXP Semiconductors, Inc. and Samsung Austin Semiconductor, LLC (collectively "NXP/Samsung"), Data Foundry, Inc. ("Data Foundry"), and the Independent Consumer Advocate ("ICA") each raise arguments that have been previously considered by Your Honor and rejected. As a result, Austin Energy will not respond in this Reply to every argument raised by the intervenors. Nevertheless, a few points bear noting. Failure to address any issue in this Reply should not be considered agreement with the position of the intervenor or a change in Austin Energy's filed position. Indeed, AE urges the Impartial Hearing Examiner ("IHE") to reject all of the Exceptions submitted by the intervenors and respectfully requests the IHE revise his position on the issues discussed in AE's Exceptions filed on July 22, 2016.

II. REVENUE REQUIREMENT

B. Decommissioning Funding

Both the ICA and AELIC submitted similar exceptions seeking to reduce the annual amount of non-nuclear decommissioning funding by extending the funding period for the Decker

Creek Power Station ("Decker") by 3.5 years (i.e. from 2 years to 5.5 years). They also re-urge their arguments to lower the overall amount of funding for Decker, the Fayette Power Plant ("FPP"), and Sand Hill Energy Center ("SHEC") by half (i.e. $80 million versus $40.224 million). Overall, adoption of these proposals would provide $40.224 million to decommission these three facilities. By comparison, the actual cost of decommissioning the Holly Street plant alone was $26 million. Extending the funding period reduces the annual revenue requirement by almost $9 million. The arguments related to the overall amount of funding have been previously considered and rejected. The new arguments related to extending the funding period are also inappropriate for the reasons discussed below.

According to the ICA, the primary differences between the IHE's recommendation and his recommendation relate to "decommissioning expense associated with Decker Units 1 & 2 and the likely timing of their decommissioning."[1] The ICA takes issue with AE's use of the upper end of the range of estimated decommissioning costs (rounded to the nearest $1 million) for units 1 and 2 at Decker. However, Mr. Mancinelli provided several reasons why it is appropriate. The cost estimates were developed and reported by NewGen Strategies and Solutions ("NewGen") in a July 2015 study which examined the entirety of AE's reserved funds and policies.[2] The decommissioning costs of Decker units 1 and 2 are based on a detailed engineering cost estimate relying upon analysis specific to these facilities. In contrast, Mr. Johnson relied upon generic formulas approved by the Public Utility Commission of Texas ("Commission") without consideration of the unique features of the Decker Units.

AELIC initially proposed a complete disallowance of non-nuclear decommissioning expense based on the fact that some of the information provided in NewGen's non-nuclear

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[1] Exceptions of the Independent Consumer Advocate to the Independent Hearing Examiner's Report at 3-4 (July 22, 2016) ("ICA Exceptions").

[2] Austin Energy's 2015 Cost of Service Study and Proposal to Change Base Electric Rates, AE Ex. 1 at 427-592.

decommissioning reserve study was redacted for competitive matters concerns. As an alternative, AELIC would extend the amortization period by an arbitrary amount of time and decrease the funding level by 48%, a percent reduction originally proposed by the ICA.[3] AELIC provided no rationale or calculation which supported its amortization period. AELIC offered no alternative retirement dates, no new amortization period for each plant, or any way to validate the $11 million total test year expense level. Consequently, the IHE rejected their arbitrary 48% decrease in decommissioning expenses outright. Now, in exceptions, AELIC attempts to provide some substance to their "delay" argument by pointing out that the date for retiring Decker has been deferred and adding a "corresponding ERCOT time lag to when decommissioning activities commence."[4] These arguments form the basis for their recommendation that funding be extended from 2 years to 5.5 years. The impact of this change, is to reduce revenue requirements by $8,909,090 (i.e. $28,000,000 / 2 years = $14,000,000 per year versus $28,000,000 / 5.5 years = $5,090,909 per year. $14,000,000 - $5,090,909 = $8,909,090). The ICA also adopts this position for the first time in his exceptions.

Everyone agrees that, in principle, AE would have started collecting decommissioning funds as soon as the plants were energized. However, that has not been the practice to date. AE has proposed establishing non-nuclear decommissioning funds to avoid future rate increases and reduce intergenerational inequities to the extent possible. To the extent AE's forecast of the decommissioning date and cost results in decommissioning costs less than decommissioning accruals, the excess reserves will be used to fund the decommissioning of FPP and Sand Hill. While the estimate of decommissioning costs will likely not be precise, it is important that AE recover all the necessary decommissioning costs prior to plant closure. It is unlikely that a future

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[3] Direct Testimony of Clarence Johnson, ICA Ex. 1 at 20:4-5.

[4] Austin Energy Low Income Consumers' Motion to Reconsider at 2-3 (July 22, 2016) ("AELIC Exceptions").

rate adjustment would be allowed to recover a shortfall in decommissioning costs for a plant that is already out of service. A shortfall in accruing decommissioning costs will result in a reduction in reserves, and a future rate case. A surplus in the decommissioning costs will result in lower depreciation accruals for FPP and Sand Hill.

In summary, AE has a unique opportunity to fund this critical reserve under a revenue reduction scenario. Through these retail rates, AE proposes to fund the decommissioning reserve at the justifiable upper level while still reducing overall system rates. From a rate administration perspective, this strategy is prudent because:

1. Given the timing of the Decker decommissioning, immediate funding of the Decker component of the Non-Nuclear Decommissioning Reserve is critical.

2. Funding the Non-Nuclear Decommissioning Reserve at the justifiable upper end will reduce the risk of future funding requirements from rates.

3. AE will not have to reduce overall system base rates to an unsustainable level, only to raise them in the next rate case to recover expenses associated with decommissioning activities. Using a portion of current base rate revenues to fund the Non-Nuclear Decommissioning Reserve satisfies an important revenue requirement objective without raising rates. This outcome is more desirable compared to facing a similar funding requirement when an overall rate increase is required.

For these reasons, AELIC and the ICA's exceptions should be rejected.

C. Internally Generated Funds for Construction

Austin Energy finances its capital improvement program ("CIP") through a combination of debt and equity, with the equity portion derived from AE's current year net revenues. Internally Generated Funds for Construction ("IGFC") is the sum of CIP, net of contributions in aid to construction ("CIAC"), financed with Net Revenues plus CIAC. AE included $88,341,455 of IGFC in the test year which was approved by the IHE.

NXP/Samsung Witness Marilyn Fox recommends only $50,000,000 be allowed for IGFC. The NXP/Samsung position is that AE should be required to borrow more money for

capital projects and lower rates in the short term. In their Exceptions, they focus on arguing that AE has not complied with the City's long term goal of achieving a 50/50 ratio.

As noted above, Austin Energy finances its CIP through a combination of debt and equity, with the equity portion derived from AE's current year net revenues. For purposes of determining the appropriate amount to be recovered in rates, AE relies upon a 50% equity financing ratio. This amount is reasonable because it is well within the range prescribed by Financial Policy No. 14 that states, "[c]apital projects should be financed through a combination of cash, referred to as pay-as-you-go financing (equity contributions from current revenues), and debt. An equity contribution ratio between 35% and 60% is desirable."[5] Additionally, 50% is representative of AE's debt to equity ratio and historical average equity financing of 51% from fiscal year ("FY") 2012 through FY 2014. Finally, AE's recommended 50% equity financing complies with City Ordinance No. 20120607-055, which directs City Council to adopt a policy of targeting debt-to-equity ratio of 60/40 until October 1, 2014, and then reaffirms a 50/50 split thereafter.

NXP/Samsung begins by arguing that AE financed 76% of its *production* costs from 2012-2015 with cash or equity. However, there is nothing in the financial policies that state every project has to be funded with the same debt/equity split. Instead, they refer to total CIP spending. As noted, Financial Policy No. 14 provides: "An equity contribution ratio between 35% and 60% is desirable." The balance sheet ratio of 45% debt and 55% equity (cash) that NXP/Samsung claims is violating the financial policies falls between the range of 35% and 60% recommended in Financial Policy No. 14. The chart below contains the level of cash spending for FY 2014 CIP. This chart demonstrates that overall cash funding was 53%.

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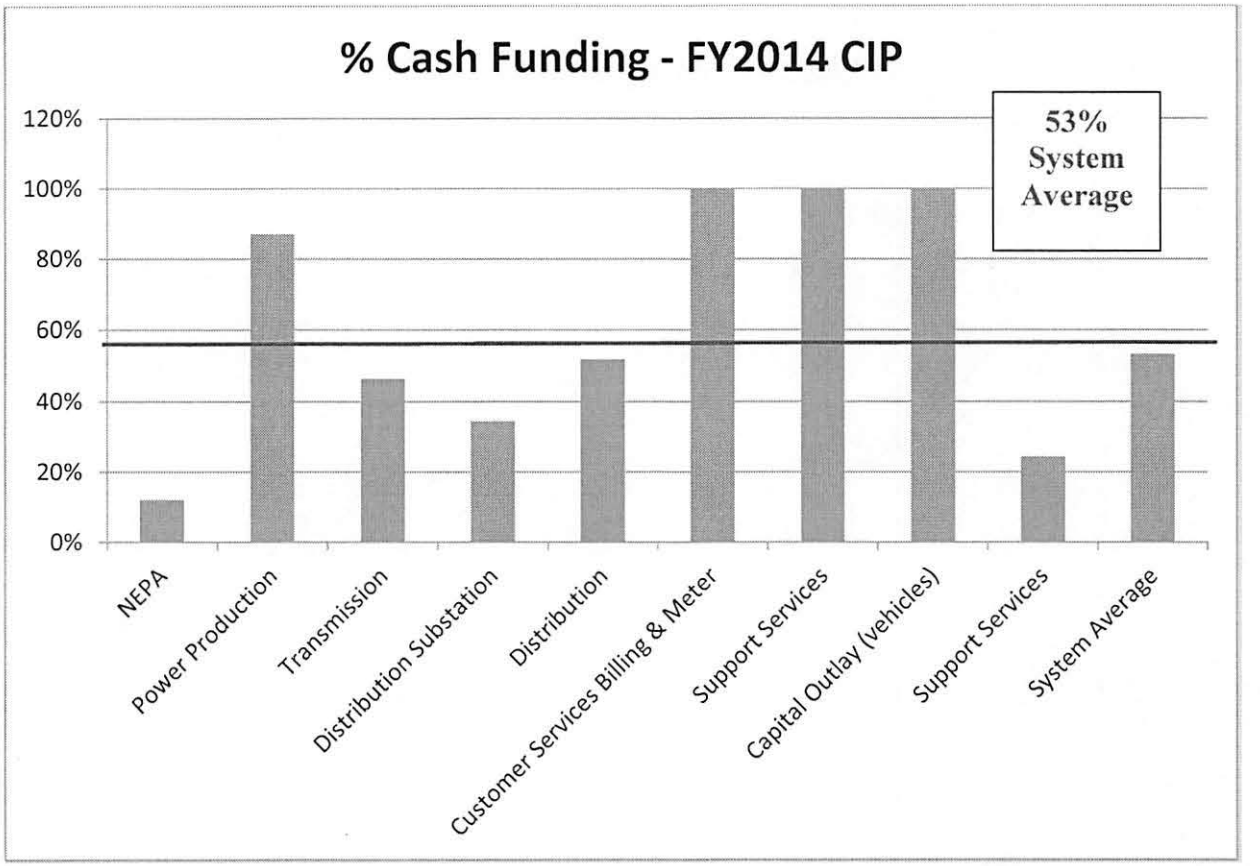
[5] AE Ex. 1 at 369 (Appendix D).



Significantly, AE does not issue bonds (i.e. debt) for short lived assets such as support services, customer services, and vehicles. As such it is appropriate for the overall amount of cash funding to exceed 50%.

NXP/Samsung also continues to argue that because the 500 MW gas fired plant has been delayed, CIP expenditures for Power Production should be eliminated. This extreme and unsupported argument ignores the fact that AE's existing plants have needs for capital expenditures. A breakdown of FY 2014 spending is as follows: $19,564,002 (Joint Projects) + $3,646,045 (Other Power Production) = $23,210,047. From FY 2012 through FY 2015, AE has invested an average of $21 million per year in CIP on its existing power plants. Austin Energy has shown that power production CIP is incurred annually and is not contingent upon City Council approving AE's next incremental power supply project. Therefore, NXP/Samsung's recommendation to exclude power production CIP is unreasonable.

As he did with respect to several issues, the ICA did not address IGFC in his direct case. Nevertheless, the ICA adopted a "compromise adjustment" of $6 million in their brief.[6] This same argument is restated in his exceptions.[7] While the ICA adds back the $21 million in production plant expenditures Ms. Fox disallowed into the CIP sum, he nevertheless disallows $12 million by normalizing the past four years of expenditures. As noted previously, AE's historical CIP for the years FY 2012 through FY 2015 is as follows: FY 2012 = $166 million, FY 2013 = $155 million, FY 2014 = $167 million, FY 2015 = $168 million.[8] As such, there is no objective basis for normalizing the past four years as the ICA proposes.

D. Transmission Costs and Revenues

At page 3 of their Exceptions, NXP/Samsung confirmed that the revenue requirement offset recommended in the Report is $12,170,081.[9] Although AE strongly disagrees with this recommendation, they nevertheless properly accounted for this recommendation in the number runs released to parties on July 20, 2016.

G. Uncollectable Expense

AE does not agree with the IHE's recommendation to base uncollectable expense on a five-year average. However, the IHE's proposal better takes into account AE's historical data than AELIC's proposed method of relying upon the unaudited FY 2015 amount.

AELIC attempts to support its recommendation by asserting that it is "within the range of value ICA witness Johnson found."[10] Simply because the unaudited FY 2015 amount falls

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[6] Post Hearing Brief of the Independent Consumer Advocate at 15, (June 10, 2016) ("ICA Brief").

[7] ICA Exceptions at 6-7.

[8] *See* AE Ex. 1 at 831 (WP C-3.4.1, line 13). The test year CIP amount of $168 million includes $10 million in non-electric costs that are excluded from the IGFC calculation.

[9] NXP Semiconductors and Samsung Austin Semiconductor, LLC's Response to Impartial Hearing Examiner's Report at 3 (July 22, 2016) ("NXP/Samsung Exceptions").

[10] AELIC Exceptions at 5.

between the average amount of bad debt experienced between FY 2010 and FY 2014 does not make it the appropriate amount to include in rates. Indeed, the purpose of an average is to take into account the annual variations in uncollectable expense experienced by AE. This is what both the ICA and the IHE did. In contrast, AELIC would set rates based upon the most recent information even though there is nothing to suggest it is representative of bad debt levels in the future. AE made a known and measurable adjustment to the FY 2014 amount for this very reason.

Unlike some expense items, the most recent information is not necessarily the best predictor of future experience with respect to bad debt. The annual historical variations attest to this fact. While the level of bad debt in the past was somewhat impacted by changes in the billing system, it will likely be impacted by other events which are beyond AE's control.[11] Moreover, as AE noted previously, a different trend may emerge in the coming year because the amount of bad debt experienced in FY 2014 is, in part, attributable to a more lenient payment arrangement policy approved by the Austin City Council in Fall 2013.[12] This policy change led to an increase in the total number of payment arrangements and a decrease in the number of successfully completed payment arrangements. This suggests that there is a distinct possibility that the level of uncollectable expenses may be on the rise again after a single year decrease.[13]

Finally, AELIC claims that, with the proposed rate decrease, bad debt levels should also decline. However, the vast majority of bad debt expense is attributable to the Residential class, which will not receive a base rate reduction under the Report's recommendations. Furthermore,

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[11] Tr. At 650:7-651:3.

[12] *See* City of Austin Code of Ordinances § 15-9-144, AELIC Ex. 36 and Tr. at 867:9-17.

[13] AELIC Witness Lanetta Cooper offered evidence from a June 2014 presentation by AE staff to the Austin City Council in AELIC Ex. 38. However, Ms. Cooper cherry picked information from AE's complete response to AELIC's RFI Nos. 10-12 and 10-13 to support her position. Had Ms. Cooper presented additional information provided in these responses using data from a more recent presentation to City Council, such as AE's May 28, 2015 presentation, a more complete picture of AE's uncollectable expense level would have been drawn in AELIC's Closing Brief.

there are many factors that impact a customer's ability to pay their bills and there is no evidence to support AELIC's claim. For all of these reasons, AELIC's recommendations should be rejected.

I. Loss on Disposal

NXP/Samsung proposes that the IHE recommend elimination of the entire $7,200,000 of losses associated with the disposal of utility assets even though the test year amount proposed by Austin Energy is recurring and representative of past and expected future experience. In their exceptions they repeat arguments that have already been considered and rejected. For example, they claim that losses on disposal should be excluded because it is not an actual expense and is "apparently" in conflict of AE's use of the cash flow methodology.[14] This is incorrect. The cash flow methodology refers to the calculation of the return and not allowable expenses.

NXP/Samsung also asserts that the test year amount is unreliable because losses vary greatly in any given year.[15] The swing in costs is partially due to an error on the reporting of FY 2013 figures. The $67,256 was reported in AE's response to NXP/Samsung RFI 4-10. The actual amount should be approximately $5.8 million higher.[16]

NXP/Samsung also claims that for FY 2015-2016 there was "in fact zero" included in the budget for losses but that the actual amount was a gain of $14,482,530.[17] This argument is flawed for two reasons. First, losses on assets are never budgeted because they are unknown until they occur. Therefore, they are not a budget based item and show up in the budget as $0. When a loss occurs, it is booked to the financial system as a non-budget entry and will not show

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[14] NXP/Samsung Exceptions at 3.

[15] *Id.*

[16] This error was identified after the hearing and is not included in the record. Of course, it is not the basis for AE's or the IHE's recommendation. If, however, the IHE believes that such information is critical, the record could be reopened to allow for consideration of this information.

[17] NXP/Samsung Exceptions at 3-4.

up as a budget based item.[18] Second, as the parties are aware, in 2016, AE received $14.5 million dollars from the sale of the Energy Control Center ("ECC"). That is the reason for the overall gain in 2015-2016. Reducing both the loss on disposal and separately as a sale of land would inappropriately double count this payment.

Finally, NXP/Samsung misapplies and misunderstands the concept of a known and measurable adjustment. Previously, NXP/Samsung admitted that the test year amount is the actual FY 2014 loss on disposal. However, they seek to remove it because the historical amount is not known and measureable. In brief, AE responded by stating that the historical test year amount is a known quantity. Now, NXP/Samsung confuses the matter more by claiming the amount is not measurable. Both of their arguments are irrelevant. In setting the appropriate amount to include in rates for loss on disposal, a regulator determines whether the test year amount is accurate, recurring, and likely to be representative of experience in the rate year. This is exactly what AE and the IHE did. In fact, the test year amount is actually lower than the amount experienced by AE in two of the three years prior to the test year.

Even if one assumes that NXP/Samsung intended to say that it is unknown whether the expense will occur in the future, their recommendation fails. Past experience, as well as Mr. Dombroski's testimony that this is a recurring expense, demonstrates that this is an appropriate expense to include in rates. NXP/Samsung's logic is that unless the future can be accurately predicted, any cost should be eliminated from rates. Respectfully, that is not how electric rates are set. Because the test year amount is representative of past experience and what is expected to occur in the future, it is reasonable to include that amount in rates.

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[18] The $14,482,530 figure on Attachment 2 to NXP/Samsung's Exceptions is taken from the City's website. It contained budgeted based number rather than actual numbers. The City's website only shows gains because AE does not budget for losses on assets.

Although the ICA took no position on this issue in their testimony or at the hearing, in their brief, they changed course and propose an $800,000 adjustment.[19] They re-urge this "compromise" in their Exceptions. According to the ICA, his adjustment is a "normalized average" of "the three years of losses entered into the record" (i.e., 2011-2013)."[20] The ICA continues to conveniently ignore the more recent test year information which is also in the record. Of course, there is no way to know if that is what is intended because the ICA developed this idea in his Brief and has not explained it any better in his Exceptions. By including the exceptionally and anomalously low loss amount for 2013, the ICA inappropriately disallows the reasonable and anticipated amount to cover losses on asset disposal.

Austin Energy has included in its cost of service the actual amount of losses experienced during the test year. As demonstrated by AE and adopted by the IHE, this is the most accurate accounting of this recurring expense and should be upheld.

J. Customer Care

NXP/Samsung claim that by adopting AE's proposed allocation of Utility Customer Center ("UCC") costs, the IHE missed an opportunity to "require AE to operate more transparently and efficiently in how the utility accounts for activities related to providing electric service."[21] NXP/Samsung provides no discussion or explanation how the current allocation method is not transparent or efficient. In fact, AE provided the total amount of UCC costs, the method for allocating the costs, and the specific amount included in AE's rates. Additionally, AE provided abundant evidence and argument in its brief explaining why NXP/Samsung's proposal to allocate UCC costs on the total number of bills is inappropriate.

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[19] ICA Brief at 26-27.

[20] ICA Exceptions at 8.

[21] NXP/Samsung Exceptions at 4.

AE pointed out that NXP/Samsung's proposal ignored the cost drivers underlying the specific allocation factors used in the KPMG model.[22] Specifically, the current allocation model appropriately attributes the costs related to these functions directly to the City's metered utilities because of the need to validate bills against the plethora of utility rates and tariffs. Therefore, it would be inappropriate to allocate these costs to non-metered utilities. Austin Energy also argued that NXP/Samsung's proposal was flawed because it incorrectly implies that a department such as Austin Resource Recovery ("ARR") and Austin Energy are responsible for a similar share of the costs, including the costs of the billing system.[23] In fact, the complexity of the electric billing system is significantly greater than the billing system for solid waste disposal. As a result, NXP/Samsung's suggestion that ARR and AE are equally responsible for the operation and maintenance of the Customer Care and Billing ("CC&B") system is inconsistent with cost causation principles.

Austin Energy also demonstrated that NXP/Samsung's proposed allocations inappropriately shift electric costs to other City departments, but lack any specific support for the adjustments.[24] Moreover, using the NXP/Samsung allocation method would lead to inappropriate increases to the customer bills of those departments. While NXP/Samsung asserts that the IHE should ignore those increases because this is a proceeding to address electric rates, this shortsighted approach fails to acknowledge the cost causation issues discussed herein.

In summary, Austin Energy provided numerous and specific reasons why NXP/Samsung's proposal to allocate UCC costs on the total number of bills is inappropriate. More importantly, the KPMG allocation model used by the City of Austin properly allocates costs to the impacted city departments and represents an appropriate and reasonable balancing of

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[22] Austin Energy's Closing Brief at 48 (June 17, 2016) ("Austin Energy Brief").

[23] *Id.*

[24] *Id.*

related benefits and burdens. AE and the City have successfully used this model, created by an independent consulting expert, for the past 14 years and it was approved by City Council in the last AE rate review. Development of this model required extensive research to determine the appropriate basis for each allocation. For all of these reasons, NXP/Samsung's exception should be denied.

M. Reserves

NXP/Samsung, AELIC, and the ICA all presented exceptions related to reserves. Most of these arguments have already been presented, responded to, and rejected by the IHE. As a result, AE will limit this reply to summarizing the errors in each of these recommendations.

NXP/Samsung continues to argue in their Exceptions against the use of the cash flow method because it is "self-prophetic."[25] Austin Energy is a municipally owned utility ("MOU") with financial policies that should be examined and reviewed through its specific MOU lens. The cash flow method is an appropriate method for an MOU and has been approved by the Commission. Furthermore, the IHE should disregard or reject any discussion about its reserve fund policies based on a critique of the cash flow method as this issue was identified as being beyond the scope of the case.[26]

NXP/Samsung also expressed concern over the rate stabilization reserve fund. In particular, NXP/Samsung is worried that the funds could lead to manipulation and potential cross subsidization issues by allowing current rate payers to pay for future costs.[27] AE is mindful of NXP/Samsung's concerns. AE agrees that the Rate Stabilization Reserve should be moved out of the overarching Strategic Reserves collection and be renamed the Power Supply Stabilization Reserve to clarify its purpose. Getting rid of the Rate Stabilization Reserve fund, however, will

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[25] NXP/Samsung Exceptions at 6.

[26] *See* Impartial Hearing Examiner's Memorandum No. 11 at 5 (Mar. 11, 2016).

[27] NXP/Samsung Exceptions at 6.

not change the total reserves needed by AE. In order to maintain at least 150 days cash on hand, the funds currently requested for the Rate Stabilization Reserve would have to be included in other fund balances.

Dedicating the Power Supply Stabilization Reserve to mitigating the impacts of volatile net power supply costs provides AE customers a shield against significant changes in the Electric Reliability Council of Texas ("ERCOT") wholesale market prices. Because the purpose of this reserve is to smooth customer bill impacts caused by variation in power supply costs, funding criteria for this reserve should be based on a range of days of net power supply costs. In summary, renaming the rate stabilization reserve fund and rededicating it to mitigating the impacts of volatile net power supply costs helps to address the concerns raised by NXP/Samsung.

AELIC proposes three exceptions that are all related to reserves in some manner. First, AELIC argues that AE's reserve requirements should be reduced from $34 million to $11 million to recognize that AE proposed new financial policies.[28] The ICA makes the same argument at page 6 of his exceptions.[29] AELIC is correct that AE proposes changes to certain financial policies. In addition, AELIC is correct that if these changes are adopted, it will reduce AE's reserve requirements. However, AELIC appears to want to recognize the lower reserve levels without actually approving the changes to the financial policies.

In testimony and in its brief, AE made it clear that it recommends the IHE adopt AE's requested revenue requirement, which is based on current financial policy, to fully fund its reserves over three years. However, Austin Energy also proposed an alternative reserve fund policy proposal based on recommendations made from NewGen's thorough study of AE reserve fund policies. AE suggested the IHE and City Council review this alternative proposal, along

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[28] AELIC Exceptions at 6-7.

[29] ICA Exceptions at 6.

with the comments of intervening parties, to determine whether or not a change to existing financial policies is warranted. Finally, AE stated that "[i]f the City Council were to adopt these recommended structural changes to AE's reserve fund policies and funding levels, AE would expect an additional decrease in the annual revenue requirement of approximately $8.2 million" assuming a three-year amortization.[30] AELIC and the ICA's recommendation to lower the reserve requirements without adopting the structural changes proposed by AE is unreasonable and should be rejected.

Second, AELIC argues that the $14.5 million realized from the sale of the ECC be reflected as an adjustment to AE's reserves.[31] Although AE disagrees with the IHE's recommendation on this issue, AE did apply these funds to reserves in running the numbers.

Third, AELIC argues that AE's reserves should be adjusted to account for the $29 million in revenues AE will realize from its regulatory charge rates.[32] Part of the costs that are recovered through the regulatory charge are transmission related costs that AE pays in order to access the ERCOT transmission system. These costs have continued to increase due to expansion of the transmission grid. Specifically, due to increases in the postage stamp rate, as well as lower than expected sales, AE has yet to make significant progress eliminating its current under-recovery. Moreover, the rate was set to recover the short-fall effective November 1, 2015. Current projections show an under-recovery of the $29 million, but the actual amount will not be known until March 2017 at the earliest. As such, it is premature to adjust AE's reserves as proposed by AELIC.

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[30] Austin Energy Brief at 56.

[31] AELIC Exceptions at 7.

[32] *Id.* at 7-8.

III. COST ALLOCATION

C. Allocation of Production Costs

Both the ICA and NXP/Samsung seem to think that AE's use of the 12CP method to allocate production costs is simply a "compromise" and is not supported by the evidence in this case.[33] In truth, compared to their recommendations, the 12CP allocation methodology more accurately reflects how the ERCOT nodal market impacts production costs and is a reasonable way to assign the recovery of those costs to AE's customer-owners. In contrast, the ICA and NXP/Samsung advocate for adoption of result-driven allocation methodologies that shift costs to other customer classes whose interests they do not represent.

As they did throughout this case, intervenors disagree in their exceptions over which production cost allocation methodology most appropriately reflects ERCOT market fundamentals and cost causation principles. The IHE's recommended ERCOT 12CP production cost allocation methodology comes closest to mirroring ERCOT wholesale market fundamentals and reasonably balances cost assignment among the various rate classes based on documented cost causation principles.

IV. REVENUE DISTRIBUTION / ALLOCATION / SPREAD

As a result of a lower revenue requirement and allocation recommendations that shift costs to commercial customers, the Report reduces the subsidization of residential customers by approximately $21 million. Nevertheless, according to the July 20, 2016 number runs, residential rates are still $25,315,688 below cost of service. Despite this, the ICA continues to recommend that the rate decrease be based on class shares of kWh consumption.[34] If adopted,

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[33] ICA Exceptions at 10. NXP/Samsung Exceptions at 7. NXP/Samsung claims that AE confirmed that a primary reason for selecting the 12CP was "political expediency of a plan that falls between the other two options." AE is unaware of ever making such a statement. Moreover, AE proposed the 12CP method before either the ICA or NXP/Samsung presented their proposals or even intervened in the case. AE does admit, however, that in contrast to the base intermediate peaking ("BIP") and average and excess ("A&E") 4CP methods, the 12CP method balances the interests of residential and commercial customers.

[34] ICA Exceptions at 16.

this would result in an 8.7% *decrease* for residential customers.[35] Ironically, the ICA assigns none of the decrease to the lighting classes because they are "far below cost."[36] Of course, the residential class is also far below cost. AE fundamentally disagrees with this proposal because the residential class is already significantly under-recovered. As such, the residential class should not be entitled to a rate decrease, an action which would exacerbate the disparity in class cost of service. Such an outcome is at odds with cost causation principles and basic notions of fairness.

The ICA also proposes to artificially inflate the decrease by incorporating an approximately $2 million base revenue increase that would be assigned to Transmission >20 MW, 85% LF ("T2).[37] If adopted, the ICA's cunning suggestion would translate into an additional $2 million disallowance to AE. The ICA correctly notes that the current T2 customer is on a fixed contract and will not be impacted by this case. However, he allocates approximately $2 million to this class because they are below cost of service.[38] He then takes the $2 million and spreads it to the other classes as though the rate decrease suddenly increased by $2 million. Because the T2 contract is fixed, AE will not realize the additional revenue from the T2 class, but will lower rates by an additional $2 million if the ICA's revenue distribution recommendation is adopted.

NXP/Samsung also discuss the proper revenue distribution in their Exceptions. They claim to use the "guiding light" of the Public Utility Regulatory Act ("PURA") and the

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[35] *Id.*

[36] *Id.* at 15.

[37] *Id.* at 15-16.

[38] Once again, it is ironic that the ICA assigns costs to classes that are below cost of service except for the class that is farther below cost, the residential class. Not only does the ICA not raise residential rates, he urges an 8.7% decrease.

Commission's rules/precedent adopted by the Commission in Docket No. 40627[39] in making their recommendations. However, they provide no details, explanation, or specific position upon which the IHE can base a recommendation.

V. RATE DESIGN

B. Seasonal Power Supply Adjustment

Although they made no mention of this issue in their testimony or brief, AELIC takes exception to the IHE's adoption of Austin Energy's proposal to implement a seasonal power supply adjustment ("PSA"). They do so without "adding any additional argument."[40] The IHE's recommendation is supported by the IHE, AE, and the ICA. Public Citizen/Sierra Club ("PC/SC") objected to this approach in its closing brief, but did not file exceptions. No other intervenor took a position on this issue in their closing briefs, suggesting the parties support, or otherwise do not object to, a seasonal PSA. For the reasons discussed in testimony, briefing, and the Report, AELIC's exception should be denied.

C. Residential

2. Tiered Energy Rates

Similarly, AELIC argues that the IHE erred in increasing the residential first tier rate because: (1) it was "done without any evidence concerning the conservation effect to the rates;"[41] (2) it creates "virtually no base rate per kWh differential between the first and second tiers inside the city and a first tier that is higher than the second tier outside the city;" (3) it does not "acknowledge that small users are cheaper to serve;" and (4) it is inequitable to have a group of

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[39] *Petition by Homeowners United For Rate Fairness to Review Austin Energy Rate Ordinance No. 20120607-055,* Docket No. 40627 (Apr. 29, 2013).

[40] AELIC Exceptions at 8.

[41] The ICA also alleges that there was not evidence "concerning the conservation effect on residential rates" but provides no other support for their opposition to the increase in the first tier. *See* ICA Exceptions at 17.

residential customers receive a rate increase.[42] For reasons discussed below, each of these arguments is either inaccurate or unpersuasive.

Contrary to AELIC's claim, Austin Energy provided evidence demonstrating that both AELIC's and PC/SC's concerns that adjusting the tiers will discourage conservation are baseless. The tiered rate structure modified according to the IHE's recommendations will continue to maintain conservation signals while also more closely aligning prices with the cost to serve to improve revenue stability. This proposal appropriately balances various policy factors and as PC/SC Witness Mr. Chernick admitted, "as long as you're not giving the energy away for free there's some incentive to conserve."[43]

AELIC's assertion that by adjusting the first tier it creates "virtually no base rate per kWh differential between the first and second tiers inside the city and a first tier that is higher than the second tier outside the city" is also misleading. Even after the increase, the energy charge for the first tier remains 40% lower than for the second tier. Additionally, for customer assistance program ("CAP") customers, the customer charge is waived. Similarly, AELIC's statement that small users are cheaper to serve is undocumented. Additionally, this claim is irrelevant insofar as the first tier specifically, and the residential class generally, remains below cost of service. Given this situation, customers in the lowest tier not only are not entitled to a rate decrease, but should receive a rate increase under the cost of service study recommended by the IHE. Some customer impact is necessary to bring the residential rate class into closer alignment with the cost to serve regardless of the fact that this is an overall rate decrease case. AE's proposal of creating a more moderate rate structure by moving certain residential class tiers closer to cost of service balances policy priorities of gradual customer impact with appropriate intra- and inter-class

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[42] AELIC Exceptions at 9.

[43] Tr. at 709:18-20.

subsidies, while achieving greater revenue stability. Therefore, AELIC's exception should be denied.

G. Group Religious Worship Discount

The ICA argues that because Houses of Worship ("HOWs") "are different than other businesses" there should be a study of their usage patterns "before the currently applicable tariffs are changed."[44] This issue was addressed in Mr. Dreyfus' rebuttal testimony. Specifically, Mr. Dreyfus pointed out that completion of the proposed studies is unnecessary insofar as these studies are unlikely to resolve any perceived concerns of those HOW customers. Additionally, Mr. Dreyfus testified that there is no cost of service ("COS") basis for distinguishing HOWs from other similarly situated customers with respect to the discount policy, and that the discount was intended to be a transition mechanism when it was adopted in the 2012 rate case. Consequently, the IHE was correct in recommending that the transition period is complete and it is now appropriate to sunset the special rate treatment for HOW accounts.

VI. VALUE OF SOLAR ("VOS") ISSUES

VII. POLICY ISSUES

A. Funding Discounts

In Austin Energy's Exceptions, the utility took exception with the IHE's recommendation of how the outside-city rate discount should be funded. Austin Energy presented several arguments in support of its recommendation that the discount continue to be funded by the same inside-city customer classes and in the same amount as the classes that receive a discount outside the city. This is in contrast to the IHE's recommendation that the discount be allocated to all customer classes in "the same manner in which AE's rate-case expenses are assigned to the various customer classes . . . ."[45] Although Austin Energy does not want to prejudice any party's

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[44] ICA Exceptions at 18.

[45] Report at 256.

position, it is important that the number runs accurately reflect the intention of the IHE.

In that regard, Austin Energy notes two additional points that became apparent in running the numbers. First, if the outside-city discount is collected in the same manner as rate-case expenses, it will be collected from 15 classes instead of the 5 that currently have an inside/outside differential. Altering the funding of the discount would shift costs to other classes that are not paying the discount currently. In particular, it will produce a rate decrease for the residential class. On its face, this would be at odds with the IHE's recommendation to adopt Austin Energy's proposed revenue distribution which holds customers classes that are below cost of service, such as the residential class, remain revenue neutral. In addition, adoption of the IHE's recommendation would allocate a rate year revenue discount in the same manner as a test year expense that uses 17 allocators. This would require a complete redesign of rates from the initial 5 classes (residential, S2, S3, P1, and P2) that had an inside/outside differential, since the discount was originally applied to them measured on the difference between the inside/outside base rates. AE would have to reset the differentials to be equal, and then apply surcharges and credits to generate the correct revenue discount for outside city customers. Finally, rate case expenses are not collected from transmission customers so if the same allocation method is used to collect the discount, not all classes would pay for the discount. Therefore, collecting the discount from all customer classes is at odds with collecting the discount in the same manner as rate case expenses.

C. Piecemeal Ratemaking

In their exceptions, both AELIC and NXP/Samsung continue to raise concerns about the overall process. Unfortunately, their arguments are unclear and incorrect. AELIC, for example, complains that the IHE's recommendation on piecemeal ratemaking did not address

"transparency concerns of the parties involving AE's annual rate hearings held between base rates cases."[46] Respectfully, AELIC confuses piecemeal ratemaking with transparency.

The fact that all aspects of AE's revenue requirement were not reviewed in this case does not mean that there is not a process for doing so. Indeed, the Austin City Council has defined processes for setting rates to recover specific categories of cost outside a general rate review. The fact that these rates are reviewed and adjusted outside a base rate case does not mean that the process lacks transparency. In fact, in each instance, the individual tariff provides specific guidance on how that rate is to be adjusted. For example, the PSA tariff states: "The PSA shall be determined as part of the City of Austin's annual budgeting process, including a public hearing."[47]

For its part, NXP/Samsung claims that the City's budget process is not comparable to the Commission where experts scrutinize changes to pass-through rates.[48] From a procedural perspective, Austin Energy established a formal proceeding that facilitated input and transparency to give more access and receive feedback from its customers. Moreover, that transparency exists only because AE remains committed to such goals. Neither independent oversight nor competition would allow for such public involvement.

As noted in Mr. Dreyfus' testimony, the City's budget process is highly participative, and open to public participation and input.[49] Furthermore, members of the public have the right to submit requests for information under the Public Information Act ("PIA"). Most importantly, AE's budget and rates are determined by elected representatives of the ratepayers, except for outside city ratepayers who have a right of appeal to the Commission. By virtue of the public's

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[46] AELIC Exceptions at 13-14.

[47] The PSA tariff can be found at http://austinenergy.com/wps/wcm/connect/15f08b08-adca-4050-93fb-e35897369d33/PowerSupplyAdjustment.pdf?MOD=AJPERES.

[48] NXP/Samsung Exceptions at 12.

[49] Approved FY 2015-2016 Budget, Vol. II at 675-76.

ability to request and review information under the PIA, the City's budget process is fully adequate for setting these pass-through charges under the provisions of the utility tariff.

D. Service Area Lighting

AELIC is the only party to address the treatment of the street area lighting ("SAL") costs in their brief or exceptions. Although they claim to be "add[ing] that it is arbitrary and discriminatory to have the same service provided with different rates" they actually made this same incorrect assertion in their brief.[50] AELIC did not offer any evidence on this issue but cited Mr. Goble's testimony as support for its position. Ironically, NXP/Samsung failed to clearly state a position in their brief and didn't address the issue in exceptions.

The SAL tariff is a cost-based rate that recovers the costs of providing electric service for illumination (*i.e.*, streetlights) and traffic signal service on public streets and highways. The tariff applies uniformly to these services whether those services are provided to accounts inside the City of Austin or outside. For customers inside the City of Austin, the costs to fund SAL are collected through the SAL component of the CBC. Austin Energy does not collect a SAL component of the community benefit charge ("CBC") from customers outside the City of Austin.

With respect to cost causation, cost shifting, and discrimination, Mr. Dreyfus testified that SAL provides a public benefit, which includes lighting and comfort to the public, but also promotes public safety, crime reduction, improved access, and reduced congestion on roadways. Moreover, because of the public benefit all customers within Austin receive from street lighting, it is well within the Council's purview to assess a charge to customers inside the City of Austin for the provision of this public benefit through the unbundled CBC.[51] For these reasons, the IHE properly determined that the SAL charge should be maintained as proposed in Austin Energy's rate filing recommendations.

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[50] AELIC Exceptions at 14. AELIC Brief at 31.

[51] Rebuttal Testimony of Mark Dreyfus, AE Ex. 9 at 26.

I. Pilot Programs

AELIC continues to urge that stakeholders be given greater input into the development of pilot programs.[52] As noted in AE's brief, AELIC's suggested modifications would negatively impact Austin Energy's ability to timely develop effective pilot programs. Under the current pilot program development process, Austin Energy incorporates the more in-depth review process at the back-end of the pilot program development. This "allows AE to develop programs quickly and test and evaluate them at the cheapest cost."[53]

Moreover, "[r]equiring Austin Energy to participate in a stakeholder process before even determining if a large-scale implementation of the project is possible would limit the utility's ability to gather concrete data and develop an internal understanding of innovative potential solutions[.]"[54] Because the current pilot program development process strikes the appropriate balance between utility autonomy, stakeholder input, and Council oversight, no action is needed at this time with respect to the pilot program development process.

VIII. STATEMENT OF POSITION / OTHER ISSUES

B. Regulatory Charge

At page 18 of their Exceptions, Data Foundry confirms that although they "initially ma[d]e some noise about the [regulatory] charge" they "ultimately chose to drop [their] opposition and accepted the rough trade off AE made in its revenue distribution."[55] According to Data Foundry, however, AE may not have "faithfully implemented" their part of the "trade off" in updating the revenue requirements model in response to the IHE's recommendations.[56]

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[52] AELIC Exceptions at 14.

[53] Rebuttal Testimony of Mark Dombroski, AE Ex. 2 at 50:4-5.

[54] Rebuttal Testimony of Kerry Overton, AE Ex. 6 at 18:1-4.

[55] Data Foundry, Inc.'s Exceptions to Independent Hearing Examiner's Report at 18 (July 22, 2016).

[56] *Id.*

Before responding to Data Foundry's number running concern, *five* points regarding the P2 regulatory charge bear repeating. First, the regulatory charge contained in the rate filing package is illustrative and based on the new voltage level approach.[57] Second, even with this increase, the illustrative P2 regulatory charge is still below cost.[58] Third, the rate based on the new voltage level approach is consistent with what the other primary customer classes, Primary <3MW ("P1") and Primary >20MW ("P3"), will be paying.[59] Fourth, the expected change to the P2 charge is not a disproportionate increase on a percentage basis, because, as explained above, the P2 class has been artificially low.[60] Fifth, P2 customers received a larger share of the rate decrease in order to offset what would have been a bill increase.[61]

The foregoing facts demonstrate not only that the P2 regulatory charge, as adopted by the IHE, is appropriate, but also that no "trade off" for the P2 class is needed to justify the redesign of the charge. That said, Data Foundry takes issue with AE's number runs, arguing that the IHE intended the P2 class be brought below cost of service.[62]

At pages 209-10 of the Report, the IHE recommended to Council:

> . . . that it adopt the proposed revenue distribution AE proposed for the initial $17.5 million revenue reduction and that the Council allocate the additional $7 million decrease associated with the CAP program in the same manner. Further, the IHE recommends to

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[57] AE Ex. 2 at 47.

[58] AE Ex. 1 at 1012 (WP H-2.6). WP H-2.6 shows the COS for P2 Regulatory is $3.61. The proposed rate is $3.16.

[59] AE Ex. 2 at 47.

[60] *Id.*

[61] AE Ex. 1 at 5-27.

[62] Consistent with the manner in which AE addressed funding the outside city discount, AE applied the revenue distribution methodology adopted by the IHE. In other words, AE did not allocate the outside city discount in a manner that would produce a rate decrease for residential customers since they are below cost. Similarly, AE did not allocate the overall revenue reduction proposed by the IHE in a manner that would bring the P2 class below cost of service when other classes remained above cost of service. AE attempted to implement the recommendations contained in the Report in the most logical and consistent manner. If, however, the IHE believes the numbers should incorporate different assumptions, AE will run them again in order to ensure that no party is prejudiced and that the IHE's recommendations are properly reflected.

> Council that if the Council reduces AE's revenue requirement beyond the approximate $24.5 million conceded by AE, that it use the same proportional relationships attendant to the $24.5 million to distribute the additional reductions.[63]

In response to these directives, AE began by allocating initial $17,474,000 in the manner proposed by AE and adopted by the IHE. Next, the $7,085,000 CAP funding adjustment was reflected to show the effects of where the residential class would be if there was no discount applied within that customer class.[64] This adjustment added $7,085,000 to the system over-recovery, while reducing how far the residential class is from cost of service. This adjustment is not a cost reduction and had no cost impacts on other customer classes. The residential revenue requirement was held constant. The $63.7 million revenue requirement reduction proposed by the IHE was then passed back to all customer classes that were over-recovered. By going to their full cost of service for P2, it will help mitigate any regulatory charge increase that this class will receive. Because the P2 class was taken to their full cost of service, they were not allocated additional discounts. This is consistent with the IHE's adoption of AE's recommended revenue distribution. Specifically, AE's position has been that they would not intentionally take a class below their cost of service.[65] For these reasons, Austin Energy accurately reflected the recommendations of the IHE on how to allocate the proposed rate decrease and Data Foundry's exception should be denied.

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[63] Report at 209-10.

[64] *See* AE Exhibit 1 at 1005 (WP G-10.2).

[65] This position was also noted in Austin Energy's brief in its discussion of how to allocate the CAP funding adjustment. See Austin Energy's Brief, at 12 ("Therefore, Austin Energy is proposing to decrease base rates by $24,559,000. This compares to the $17,474,000 decrease proposed in Austin Energy's initial filing. AE proposes this additional revenue be allocated using the same approach that was applied to its initial filing. *However, if a class reaches its class cost of service, the remaining amount will be applied to the other classes.*" Emphasis added).

IX. CONCLUSION

In conclusion, Austin Energy respectfully requests the IHE affirm the Report with respect to the points discussed in brief and this Reply. Austin Energy further requests that the IHE grant AE's Exceptions to the Report. Finally, AE requests any and all additional relief to which it may be entitled.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of this pleading has been served on all parties and the Impartial Hearing Examiner on this 1st day of August, 2016, in accordance with the City of Austin Procedural Rules for the Initial Review of Austin Energy's Rates.

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